IN THE

Supreme Court of the United States

October Term, 1939.

No. 34.

ESTATE OF CHARLES HENRY SANFORD, Deceased, Jennie R. Baird, Substitutionary Administratrix, c. t. a.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

REPLY BRIEF FOR THE PETITIONER.

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REPLY BRIEF FOR THE PETITIONER.

The Solicitor General has filed a single document, comprising at one and the same time the Government's reply brief in the *Sanford* case, No. 34, and its main brief in the companion case, the *Humphreys* case, No. 37.

"The two cases at bar", says the Solicitor General (p. 10), "present a single question of statutory interpretation", a statement in which we entirely concur. As the respondent in No. 34 and the petitioner in No. 37, he admits (p. 11) that the Government has "necessarily been forced" to take "inconsistent positions" in the two cases. He then adds: "A decision favorable to the Government in either case will necessarily preclude a favorable decision in the other." Again we agree.

Believing that "a genuine doubt" exists "as to the proper interpretation of the statute" (p. 11), the

Solicitor General announces that "we do not feel justified in urging upon the Court adoption of either view to the exclusion of the other". Accordingly, in Part I of his brief the Solicitor General sets forth "The argument in support of the Government's position in the *Humphreys* case" (our position in the *Sanford* case), and in Part II "The arguments in support of the Government's position in the *Sanford Estate* case" (in opposition to us).

We are not unappreciative of this attitude of what we may call "benevolent neutrality", and we sympathize with the unhappy position in which the Solicitor General finds himself. Nevertheless, it seems unfortunate that the Department of Justice is unable to reach a definite conclusion on a point of law of such vital importance in the proper administration of the Federal revenues. At no point are we advised, nor is this Court informed, whether the Solicitor General is for us or against us, wherein lie the interests of the Treasury Department charged with enforcing the statute under consideration, or which of the two conflicting constructions of the statute he considers sound.

Throughout the brief there is a use of phrase and a treatment of the decisions of this Court unusual in a brief in opposition, but possibly inevitable on account of the dual position taken. Both in Part I and Part II there constantly appear such phrases as "there are persuasive reasons for believing" (pp. 22, 29), and "this would seem to indicate" (p. 22), and "the assumption seems warranted" (p. 27), and "it may plausibly be argued" (p. 40). The Solicitor General's treatment of the decision of this Court in *Burnet* v. *Guggenheim*, 288 U. S. 280, a case of major importance as it bears upon the issue presented, is in similar vein. "The opinion of this Court", says the Solicitor General (p. 18), "can be

used as the basis of an argument on either side of the issue involved in the present cases". For our part we believe that the *Guggenheim* case is square authority in support of our position, both in its reasoning and in its ultimate holding. The Solicitor General does not say whether he agrees or disagrees.

With a Government brief so cast, there is real difficulty in focusing the issue between "the opposing parties" to this lawsuit. We counter upon one assertion made, only to find that at another point the Solicitor General undertakes to cast doubt upon the same contention, yet does not repudiate it. Our real opponent appears to be the respondent in the *Humphreys* case, No. 37. Confronted with this situation, in this reply we shall discuss the statements made in the Government's brief with which we do not agree and endeavor to clarify where clarification seems necessary, and then discuss briefly the contentions of the respondent in the *Humphreys* case.

I.

Comments on the Solicitor General's arguments in support of the Government's position in the *Humphreys* case (our position in the *Sanford* case).

There is much with which we agree, although there are certain points of difference.

After stating (pp. 12, 22) that the language of the 1924 Act itself implies an intention to impose the tax upon the "transfer", as distinguished from the receipt, the Solicitor General says (p. 22): "Unquestionably there was, in both cases at bar, a completed transfer of property when the power of revocation was relinquished."† This, of necessity, must be true,

† Compare this statement with the statement at the bottom of page 40, namely:

"* * * it may plausibly be argued * * * that there is not a completed gift from the donor."

since the trusts in both cases were valid gifts in trust and did not fail for the lack of a donee capable of taking, namely, the trust estate as a whole.

The Solicitor General then advances an argument of telling weight. The donor, he says (pp. 12, 22), is the one primarily made liable for the tax. This indicates a legislative intention to impose the tax on the transfer rather than on the final vesting of rights in the beneficiaries. If the tax is upon the donor at the date of transfer from the donor, such a valuation date "most truly measures his donative intent". If, on the other hand, the imposition of the tax is postponed until the ultimate beneficiaries are finally fixed, which may not occur for many years, future fluctuations in the value of the property may occur which will materially affect the amount of the tax imposed, thus confronting a would-be donor with complete uncertainty as to the amount of his liability, and in many instances reducing materially the amount of the tax. To impose the tax at the point where the grantor irrevocably parts with the property means the use of a valuation date permitting a ready determination of the tax, and the amount of the tax so computed will accurately reflect the amount of the gift. As the Solicitor General says (p. 12), such a determination of the tax is "most consistent with the philosophy of the tax".

The Treasury Regulations.

We do not subscribe to the Solicitor General's interpretation of the Treasury Regulations. He says (p. 12) that "they do not specifically cover the present situation", although they "contain the implication that the tax is to be imposed" when the grantor surrenders the right to retake. On the contrary, we submit that the Treasury Regulations unequivocally and

without shadow of doubt apply, and were intended to apply, to the very class of trusts with which we are here dealing.

The language of the Regulations is clear and unambiguous. "A taxable transfer", read the Regulations, "will be treated as taking place" in the year in which "the power retained by the grantor to revest in himself title to the corpus" is terminated. Sanford, in 1919, irrevocably surrendered the power "to revest in himself title to the corpus" of the trust created in 1913. Similarly on the creation of the Humphreys trust in 1934 Humphreys irrevocably surrendered the power "to revest in himself title to the corpus" of the trust. If the tax attaches on a prescribed event, namely, the surrender by the grantor of the power "to revest in himself title to the corpus", under the clear-cut language of the Regulations it must necessarily attach on the occurrence of that event, whether or not there is the retention or nonretention of any other power.†

With the exception of the Court below, every authoritative voice which has undertaken to construe these Regulations has so interpreted them. As we pointed out on page 20 of our main brief, the Chief Counsel for the Bureau of Internal Revenue in the second *Sanford* ruling (G.C.M. 14774) quoted Article 1 of Regulations 67 (1924 Edition) and laid his

† The Solicitor General himself inferentially has recognized the inevitableness of such a construction. On pages 57-58 he sets forth *in extenso* Article 3 of Regulations 79 (1936 Edition), and at the top of page 58, at the end of the sentence in the Article stating that "The relinquishment" of the power to revest "is regarded as the event which completes the gift and causes the tax to apply", he drops down a footnote reading:

"So held in *Burnet* v. *Guggenheim* (288 U. S. 280, 53 S. Ct. 369) of a transfer in trust, made in 1917, with power in the donor to revoke, which power he relinquished in 1925, the relinquishment being treated a gift subject to the tax imposed by the gift tax title of the Revenue Act of

opinion squarely upon the Regulations. Again, in G.C.M. 19260, the Chief Counsel specifically said (R. 29): "G.C.M. 14774 gives full effect to the regulations".

The Commissioner of Internal Revenue has so construed the Regulations. It is a matter of record that the Commissioner has closed or adjusted approximately 300 cases "of the character of that here involved" in accordance with the Regulations (R. 13); and during the course of the *Humphreys* case when the Respondent's motion for summary judgment was filed, the Government counsel stated to the Court "that the Commissioner had not acquiesced in" the *Hesslein* case (Res. Brief, p. 9).

In the *Hesslein* case, Judge Swan had before him Article 3 of Regulations 79 (1933 Edition) (see Res. Br., p. 27), which, as the Solicitor General concedes (p. 25), is identical with Article 1 of Regulations 67 (1924 Edition), and Judge Swan unqualifiedly stated that this Regulation "has construed the statute as imposing a gift tax on such a transaction as the one involved in the case at bar."

Finally, the Solicitor General by his own statement refutes his assertion (p. 12) that the 1924 Regulations do not "specifically cover the present situation". On pages 25-26 of his brief, he quotes *in extenso* from the 1936 Edition of Regulations 79 issued under the 1932 Act. "The tax is not imposed upon the receipt of the property by the donee", read these Regulations, "nor is it conditioned upon the ability to identify the donee at the time of the transfer". On the contrary, "the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then

be known or ascertainable". And again, "The relinquishment or termination of the power [i.e. to revest in himself] occurring otherwise than by the death of the donor * * * is regarded as the event which completes the gift and causes the tax to apply".

This Regulation, the Solicitor General concedes, unquestionably covers the situation here involved, for he says (p. 26) that Regulations 79 (1936 Edition) "seem clearly to contemplate that the creation of an irrevocable trust or the relinquishment of a power of revocation constitutes a taxable gift *irrespective of the reservation of a power of modification*". (Italics supplied.)

But if this is so, it necessarily follows that the earlier Regulations prescribe, and were intended to prescribe, the same rule. Regulations 79 (1936 Edition) unquestionably are simply a reiteration of the rule announced in the earlier Regulations and an amplification of its statement. The second and favorable *Sanford* ruling (G.C.M. 14774) was promulgated on April 8, 1935 (see our main brief, pp. 7-8; R. 12). Regulations 79 (1936 Edition) were promulgated on February 26, 1936. Thus the 1924 Regulation, the 1932 Regulation and the *Sanford* ruling ran side by side with the 1936 Regulation for almost two years. The stipulated uniformity in practice of the Commissioner in adjusting cases of this character since the enactment of the 1924 Act until the decision in the *Hesslein* case in 1937 affirmatively testifies to the identity of the rule under all the Regulations.

The Guggenheim Case.

The Solicitor General's treatment of the *Guggenheim* case, as we have pointed out above, is not satisfactory. On page 24, he says: "If the Guggenheim decision means that any relinquishment of a power of revocation is a taxable gift, the Sanford gift was

completed in 1919 and consequently his subsequent renunciation of the power of modification is not subject to tax". He then goes on to say that while this interpretation finds "considerable support" in the language of the opinion, "it seems doubtful" whether the decision may properly be interpreted as authority for such a broad proposition. Yet at another point (p. 23), after quoting from the opinion that "a gift is not consummate until put beyond recall", he says: "This language may well be deemed to contain the negative indication that transfers, such as the ones here involved, which are beyond recall * * * do constitute taxable gifts within the meaning of the statute."

As we pointed out in our main brief (p. 41 *et seq.*), the reserved power in the *Guggenheim* case included the power to revoke, and it was the effect on the grantor's interest in the property occasioned by the surrender of the power to revoke which was the *ratio decidendi* of the decision. Clearly Congress was under the impression that this was the effect of the decision when it repealed Section 501(*e*) of the 1932 Act. That Section specifically provided that the relinquishment of "the power to revest in the donor title to" the property in trust "shall be considered to be a transfer by the donor by gift", language which squarely covers the situation here involved. The two Committee Reports accompanying the repeal placed the repeal on the ground that "the principle expressed in that section is now a fundamental part of the law by virtue of the Supreme Court's decision in the *Guggenheim* case". We think Congress properly construed the decision of this Court in that case. In any event, this action by Congress is conclusive evidence of the legislative intent.

The Secondary Liability of the Donee.

In discussing the effect of the secondary liability of "the donee" (pp. 31-32), the argument of the Solicitor General is not wholly satisfactory, though in general we concur. After quoting Section 510 of the 1932 Act imposing a ten-year lien on the property and providing that if the tax is not paid when due "the donee" shall be personally liable for such tax, the Solicitor General says: "We think it probable that Congress intended that in such event the trust estate should be made to respond for the tax in the first instance by enforcement of the statutory tax lien." He then adds that if this is true, the liability of the donee (which he assumes is the beneficiary) is imposed upon him "only when the gift to him is completed" (meaning, we presume, the surrender of the power to change). Under this argument, the secondary liability would fall in the first instance on the trust estate to the extent of the ten-year lien on the property, and only secondarily on the beneficiaries, and then to the extent only of the value to each of the interest of each when such interest becomes fixed.

This, we believe, is a feasible interpretation of the 1932 Act from a practical standpoint, except that we should say the liability of each beneficiary would be his *pro rata* share of the liability of the donor, for the secondary liability unquestionably is derivative, and, as the Solicitor General says on page 23, the theory of the statute contemplates as the valuation date the time of transfer from the donor. Certainly, as the Solicitor General says (p. 32), it is not reasonable that a single beneficiary should be liable for the entire tax, when his interest may be only a minor one.

But we are not fully convinced that this is the proper interpretation of either the 1924 or the 1932 Act. As we pointed out on page 56 of our main brief,

the 1924 Gift Tax Act did not undertake to make the donee secondarily liable, but by reference to the estate tax provisions a ten-year lien attached to the donated property, and in the case of a trust "the trustee" as custodian of the property subject to the lien was liable for the tax in the event the donor failed to pay. In the 1932 Act, the secondary liability was imposed broadly on "the donee", coupled with a ten-year lien on the property. Under the 1932 Act, it is quite consistent with the canons of interpretation to treat the trust estate as "the donee" for this purpose. If so, then on the failure of the grantor to pay, the tax would be payable out of the trust property, thus depleting it to the extent of the tax and so indirectly spreading the burden of the tax over the several beneficiaries *pro rata* in accordance with the interest of each. If the corpus of the trust is so depleted on account of the collection of the gift tax, the beneficiaries, whether those originally designated or later substituted, cannot complain, for they gave no consideration but are merely the recipients of the donor's bounty. This accomplishes the same end as the suggestion of the Solicitor General (p. 32) that if the beneficiaries who are dropped out should be compelled to pay, they would have "a right of reimbursement from the trust estate or from the ultimate beneficial takers". But, in any event, as the Solicitor General himself says (pp. 32-33), it is somewhat strained to undertake to fix the point at which the gift tax attaches on account of possible hardships which might arise under one of several possible constructions of another ambiguous section of the law.

The Porter Case.

The Solicitor General (p. 33) takes issue with our interpretation of the *Porter* case, arguing that Section 319 of the Gift Tax Act is unlike Section 302(a) of the Estate Tax Act. Section 302(a) requires the inclusion in the gross estate of any "interest" existing at death, while Section 319 taxes a present "transfer" by gift. Under Section 302(a) the word "interest" connotes, we submit, the existence at death of a beneficial interest; and under Section 319 the word "transfer" connotes, we submit, a shift in beneficial interest from the grantor to others. Fundamentally, therefore, the incidence of the tax under both sections is the same. The Solicitor General points out that in the *Reinecke* case this Court held that the existence on death of a power of revocation brought the property into the gross estate under Section 302(c). But under this Court's decision in the *Guggenheim* case and particularly its more recent decisions in the *McCanless* case and the *Graves* case, wherein the power of revocation was said to constitute the "equivalent of ownership", the inclusion in the gross estate of property subject on death to a power of revocation might equally have been supported under Section 302(a).

Tax Postponement and Tax Avoidance.

The Solicitor General says that "we do not believe" a decision either way in these cases will have "any predictably adverse effect upon federal revenues" (pp. 11, 37, 50), adding (p. 36) that "we cannot agree that a decision that the tax attaches only upon relinquishment of the power of modification would permit 'flagrant and widespread income tax avoidance' ". At no point does he deny our assertion that under the rule of the *Hesslein* case

the collection of gift taxes would be indefinitely postponed if not entirely frustrated.

The Solicitor General's statement is indeed astonishing in view of the record in this case. Whatever view the Department of Justice may have on the matter, the attitude of the Treasury Department is not in doubt. Rarely has a question been given more careful and thorough consideration by the Internal Revenue authorities than the one raised in the *Sanford* case. First a hearing was had in 1934 before the Miscellaneous Tax Unit, at which the question was fully argued and considered (R. 12). After reference of the question to the Assistant General Counsel for the Bureau, a second and even more extended conference was had, at which Arthur H. Kent, acting for the Assistant General Counsel in his absence, and some ten or twelve representatives of the Treasury, were present (R. 12). In the second and favorable ruling, the Assistant General Counsel said (R. 21) that "upon a careful consideration" the Bureau must "adhere" to the position that the gift tax attaches on the relinquishment of the right to revest, adding that if the vesting of title in the donee were to be adopted as the criterion "any such rule would not only be in conflict with the court decisions and regulations cited but, it seems certain, would also lead to many difficulties of an administrative character and otherwise". What these are it is not difficult to discern. We have the explicit testimony of Mr. Kent, a responsible Treasury official, who, in delivering the *Sanford* ruling for transmission to the Under Secretary of the Treasury, said (R. 28):

> "I am now convinced that the position tentatively taken in the prior opinion should not be maintained, and that its possible prejudicial re-

sults upon the revenues both from gift tax and income tax far outweigh the considerable revenue we would gain from asserting a gift tax liability against this trust. Even though we won in the courts, which seems unlikely under the present statutes and regulations, our victory would be a Pyrrhic one."

There was no doubt in Mr. Kent's mind that the rule of the *Hesslein* case would be definitely prejudicial to the Federal revenues, both from the standpoint of the gift tax and of the income tax. The proposed tax which Mr. Kent had under consideration would, with interest, amount to well over a million and a half dollars. The fact that the "possible prejudicial results upon the revenues" would "far outweigh" this "considerable revenue" serves to indicate the extent of the Treasury's apprehension of the adverse effect on Federal revenues, if the other rule were adopted. The Government in its petition for certiorari in the *Hesslein* case (No. 556, October Term, 1937) estimated that approximately $5,000,000 must be refunded in back gift taxes under that decision. This does not take into account the loss of future gift tax revenue or the future savings in income taxes under such a rule. Nor is it without significance that despite the decisions in the *Hesslein* case, the *Humphreys* case and this case below, the Treasury has not modified its formal Regulations.

Congress itself in 1924 realized the need of the rule in order to prevent income tax avoidance. From the Congressional debates at the time of the first Gift Tax Act (see our brief, pp. 35 *et seq.*), it is abundantly clear that the two major purposes sought to be accomplished were the prevention of estate tax avoidance by the making of *inter vivos* gifts, thus reducing the high estate tax brackets, and

the prevention of income tax avoidance by splitting up large estates, thus reducing the surtax rates and so the income taxes.† These debates show that as early as 1924 the wealthy taxpayers of the country already had resorted to the device of splitting up large property holdings for the purpose of reducing and so saving income taxes. If in the case of a gift in trust the gift tax is payable at the point where the burden of the income tax shifts from the wealthy donor to the trust estate, either the would-be donor must refrain from making gifts and continue to pay the high income surtaxes on all his property, or if he makes a gift, thus saving income taxes, he must pay a gift tax. On the other hand, if the gift tax is withheld at the point where the burden of paying income taxes shifts from the donor to the donee and is imposed later on when the limited power of modification is surrendered (if ever), the door is wide open to income tax avoidance, for the gift tax will not operate as any deterrent in the splitting up of the property. Under such a rule, a tax saving loophole undeniably will exist, and will as certainly be availed of.

We may say here, as Mr. Justice Cardozo so pertinently said in *Burnet* v. *Wells*, 289 U. S. 670, 675:

> "By the creation of trusts, incomes had been so divided and subdivided as to withdraw from the Government the benefit of the graduated taxes and surtaxes applicable to income when concentrated in a single ownership. Like methods of evasion, or, to speak more accurately, of avoidance (*Bullen* v. *Wisconsin*, 240 U. S. 625, 630), had been used to diminish the transfer or succession taxes payable at death. One can read in the revisions of the revenue acts the record of the Gov-

† This the Solicitor General concedes on p. 45 of his brief.

ernment's endeavor to keep pace with the fertility of invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens."

The Solicitor General commenting upon our argument in this respect says (p. 37): "The argument is premised on the assumption that, if threatened by the immediate imposition of a gift tax, the would-be donor would decide not to make the transfer at all * * *," adding (p. 38) that "there are reasons why it cannot be assumed that this would be the reaction of the donor". No one, of course, can predict what a particular would-be donor might do. But the fact remains that if the rule of the *Hesslein* case is adopted, there would exist a broad and obvious loophole in the Federal statutes, and it is certainly not unreasonable to assume that the wealthy taxpayers immediately will take advantage of it, certainly in view of the high and very painful surtaxes.

The Solicitor General (p. 37) asserts that if Congress "had intended to guard against such avoidance, it would have done so directly by taxing the income from such a trust to the grantor, rather than indirectly by imposing a gift tax upon the creation of the trust". There is no support for this statement. In the first place, as we point out in the footnote on page 32 of our main brief, it probably would be beyond the power of Congress to close the income tax loophole by undertaking to lay the tax on the grantor after the grantor has lost all right to retake for himself the corpus or income, for as the Government in its brief in the court below expressly said, "A tax cannot constitutionally be imposed on one person with respect to income which belongs wholly to another." (See p. 32 of our main

brief.) Congress is as fully aware of such a limitation on its power as are the courts. In view of the constitutional difficulty, Congress would hardly seek to close the loophole in this fashion when it might so readily do so by the means of enacting a gift tax effective at the point where the burden of paying the income tax shifts from the grantor to others. If any conclusion is to be drawn from this condition of affairs, surely it is that Congress was fully aware of the matter and acted to close the loophole by exerting its unquestioned power to impose an excise tax on gifts, effective at the necessary point.

It is not our "solicitude" for the Government revenues which leads us to emphasize the tax postponement and tax avoidance implicit in the rule of the *Hesslein* case, as the Solicitor General seems to imply (p. 36). As we endeavored to make clear in our main brief (pp. 27 *et seq.*) we are here seeking to get at the intention of Congress. Where one of two alternatives in the interpretation of a revenue statute will result in tax postponement and tax avoidance while the other will prevent such a state of affairs and at the same time insure complete harmony between different parts of the same Act, it would be quite unreasonable to impute to the lawmakers an intention to adopt the former course. Surely Congress is not unmindful of conserving the Federal revenues, even though we may be less solicitous.

II.

Comments on the Solicitor General's arguments in upport of the Government's position in the *Sanford* ase (in opposition to us).

Generally speaking, in this part of his brief the Solicitor General follows the line of thought indulged n by Judge Swan in writing for himself and Judge Manton in the *Hesslein* case. The argument is rested argely upon the assertion that a gift in trust is "incomplete" so long as the identity of the ultimate beneficiaries remains uncertain† (see Res. Br., pp. 38-39).

The Argument of Incompleteness.

The Solicitor General says (p. 39) that for the purpose of "completeness" of the gift, it is necessary to ay that the trustee is the donee, adding: "If that vere true, the tax could be imposed upon a transfer n trust for the benefit of the donor." Quite obviously his does not follow, for in such a case there is no eal "transfer" from the donor to anyone. The "transfer" subject to tax unquestionably contemplates he transfer of the beneficial ownership, and in the ase suggested, the beneficial ownership remains in he donor, as well after as before the creation of the rust.

The Solicitor General (p. 39) rejects our argument f "completeness" predicated by analogy upon an absolute trust with contingencies set up in the trust nstrument itself. Says the Solicitor General (p. 40):

> "In such a case the grantor has fully exercised his power to choose beneficiaries * * *, even though the ultimate beneficiaries might not

† Compare this statement with the Solicitor General's statement quoted on page 4, *supra*.

be known until certain events have occurred * * *. The gift to those ultimate beneficiaries is as complete as the donor can presently make it."

This, of course, is true. But the Solicitor General does not undertake to say whether in such a case the gift tax is imposed upon the creation of the trust, or whether it is withheld until the final contingencies definitely fix the ultimate beneficiaries. His silence is significant. In such a case, who is "the donee", and against whom is the tax? Are we led to believe that in such a case the gift occurs on the creation of the trust, as we confidently maintain, or at a later date, perhaps even after several years, when the contingencies occur? The Solicitor General does not say. If the latter, the value of the property which constitutes the subject matter of the gift may have fluctuated widely between the date of transfer and the date of ultimate enjoyment. Is it conceivable that a donor should be left in such complete doubt as to the amount of the tax due, when the imposition of the tax on the creation of the trust insures an exact measure of his liability? Precisely the same considerations apply to such a trust as in the case of the trusts here involved.

The case of a charity presents no problem, for if non-charitable beneficiaries are first named and later a charity is substituted, this happens by the grantor's own voluntary act, and the charity cannot complain because a gift tax has been collected on the creation of the trust, or as in a case such as ours, on the surrender of the power to revest.

The Solicitor General goes farther even than Judge Swan in the matter of "incompleteness" of the gift. He says (p. 40) that while the donor has made "a complete transfer of all his property rights in the trust estate", nevertheless he retains sufficient disposi-

tion of the property "as to afford him considerable indirect economic benefit from the property", a right which is (p. 41) "closely akin to a property right". The Solicitor General argues (p. 40) that the named beneficiaries or prospective donees "would be influenced" to act in accordance with the donor's wishes, implying that in this indirect fashion the donor in some way could enjoy for himself the benefit of the property. This is much the same argument which the Government advanced in the *Knapp* case in support of its effort to collect an income tax from the grantor after he had surrendered the power to revest corpus and income in himself. In the Circuit Court the Government argued that Knapp might cancel the rights of all the beneficiaries, might appoint the trust to his estate and thereby become the sole beneficiary, with the power to terminate and revest the corpus in himself. "The difficulty with this contention", said Judge Hand, "is that the language [of the trust] gave him no such power". The Government also contended that with the unlimited right reserved to appoint new beneficiaries, the settlor might select dummies of his own who would complacently cooperate in revoking the trust, and then the settlor might revest the corpus in himself. But Judge Hand again rejected such a contention, saying that the settlor did not have any such power in view of the limiting clause in the trust deed.

The Solicitor General advances the *Porter* case as opposed to our position. As we have pointed out on pages 48-50 of our main brief, Mr. Justice Butler's reasoning does not lend itself to this view. Starting with the premise that the non-beneficial power to modify there involved "did not amount to an estate or interest in the property", he sustained the inclusion of the corpus on the somewhat narrow ground

that what was reached reasonably might be deemed "a substitute for testamentary disposition." But, says the Solicitor General, the significant thing is that the inclusion of the property was upheld in spite of the fact that the trusts were created before there was any provision in the estate tax law taxing such transfers. For our purposes, there is no significance in this argument. The *Porter* case merely holds that in the case of such a power there passes at death some kind of right in respect of the property which is sufficient to support the final death tax. For the purposes of this case, we concede that the surrender of a non-beneficial power to modify is an event which may sustain an *inter vivos* tax if Congress so decrees, as it may also sustain a final excise tax upon death. The question here is not one of legislative power or lack of power; it is wholly one of legislative intention.

The Pari Materia Argument.

The Solicitor General (p. 42) misconstrues Mr. Justice Cardozo's comment in the *Guggenheim* case that the gift tax and the estate tax are in *pari materia,* just as Judge Swan misconstrued the statement. The Solicitor General on pages 42 and 43 sets forth *in extenso* the paragraph of Mr. Justice Cardozo's opinion which contains this statement, and perhaps a perusal of the entire paragraph may best indicate what the Learned Justice really had in mind. Directly following this statement and quite evidently directing his attention to the gift tax, the Learned Justice said:

> "There is little likelihood that the lawmakers meant to narrow the concept, and to revert to a construction that would exalt the form above the substance, in fixing the scope of a transfer for the purposes of Part II [i. e. the gift tax]."

After saying that the estate tax was "the outcome of a long process of evolution", he added:

> "The tax on gifts was something new. Even so, the concept of a transfer [i. e. the shift of economic benefits] so painfully developed in respect of taxes on estates, was not flung aside and scouted in laying this new burden upon transfers during life. Congress was aware that what was of the essence of a transfer had come to be identified more nearly with a change of economic benefits than with technicalities of title."

Thus it is clear, as we point out on page 45 of our main brief, that Mr. Justice Cardozo's statement was simply in support of his main thesis that form should not be exalted over substance. To this extent, the gift tax and the estate tax are in *pari materia*. But this is a long way from saying, as Judge Swan said in the *Hesslein* case, that the two statutes are so closely akin that it is reasonable to construe the gift tax "as excluding gifts so incomplete by reason of powers reserved to the donor, as to be expressly made subject by the latter to the estate tax." Here lies the fundamental fallacy in Judge Swan's reasoning.

The Argument Predicated on the Secondary Liability of the "Donee".

We have already covered this point (p. 11, *supra*) in discussing the Solicitor General's argument in Part I of his brief (in support of our position). In Part II, the Solicitor General undertakes to counter on his own argument earlier advanced on pages 31-32, but only in a rather half-hearted fashion. He says (pp. 48-49) that the correlation argument "is bolstered" by a consideration of Section 510 imposing a secondary liability upon "the donee". We think not, for the reasons which we have already set forth on pages 9 *et seq.*, *supra*.

We have already considered the argument predicated upon the later substitution of a charity (see p. 18, *supra*).

The "Basis" of the Hesslein Case.

At several points in his brief the Solicitor General misinterprets "the basis" of Judge Swan's reasoning in the *Hesslein* case (See pp. 13, 15, 21, 29). For example, on page 13 the Solicitor General says:

> "That decision was based upon the premise that the gift and estate taxes were intended to be correlative and that since the termination by death of a power of modification effects a transfer subject to the estate tax [citing the *Porter* case], the termination of such a power by the donor during his life should be deemed to be the taxable event for purposes of the gift tax."

This is not Judge Swan's reasoning at all. Such reasoning might equally well be urged in support of our position. The Estate Tax Act covers property subject to a power to revoke as well as property subject to a power to modify, and it might equally well be said that since the termination by death of a power of revocation constitutes a transfer subject to the estate tax, the termination of a power of revocation by the donor during his life should be deemed to be the taxable event for the purposes of the gift tax.

Judge Swan went far beyond this. Saying that the primary purpose of the gift tax is to supplement the estate tax, he asserted that the gift tax should be construed "as excluding gifts so incomplete by reason of powers reserved to the donor, as to be expressly made subject" to the estate tax. Judge Swan's argument is that so long as property remains within the scope and orbit of the estate tax, the gift tax does not attach, even though the language of the act lays the

tax on the *inter vivos* "transfer * * * by gift". Only if we fully realize Judge Swan's approach do we see how fundamentally fallacious it is.

III.

Comments on the arguments of the respondent in the *Humphreys* case.

In considering the arguments advanced by the respondent in No. 37, three points must be clearly kept in mind with respect to that case.

First, the trust indenture made a complete disposition of the estate, *i.e.* to the grantor for life with remainders over, part vested and part contingent, subject to the power reserved.

Second, the gift there involved was the value of the remainder only (a future interest), since the grantor named himself as the life tenant.

Third, under Humphreys' argument, the reserved power to modify, if never surrendered, will frustrate the gift tax entirely; the grantor will remain subject to the income tax so long as the reserved life estate stands. If, however, the grantor, acting under the power to modify, substitutes another as life beneficiary, no gift tax will be payable in respect of the transfer of the life estate, and the grantor will be free from the burden of the income tax. *Knapp* v. *Hoey*, 104 F. (2d) 99 (discussed on p. 31 of our main brief), recently followed and applied in *Corning* v. *Commissioner*, C.C.A. 6th, decided June 6, 1939, 1939 Com. Cl. H., Vol. 4, p. 10291, and *Commissioner* v. *Perkins*, C.C.A. 1st, decided June 13, 1939, 1939 Com. Cl. H., Vol. 4, p. 10335. This is a very nice tax scheme indeed, for under it the grantor and not the Treasury will control the imposition of taxes, assuming, of course, that Humphreys' argument is sound.

The respondent in No. 37 adopts (p. 5) "many of the arguments" advanced by the Solicitor General in Part II of his brief. These we have already dealt with. We shall consider briefly certain of his additional contentions.

Humphreys says (p. 7) that the Second Circuit in the *Hesslein* case had "practically the same arguments" before it as are now advanced, adding that many taxpayers undoubtedly have adjusted their financial affairs in reliance upon the *Hesslein* case. We respectfully submit that the first comment is not accurate (see p. 12 of our main brief), and the second is highly doubtful, for the *Sanford* case was instituted immediately upon the decision in the *Hesslein* case, and everyone, including the informed taxpayers of the country, at once realized that the *Hesslein* decision was not the last word.

In the footnote at the bottom of page 11, Humphreys argues that the phrase "put beyond recall" as Mr. Justice Cardozo used it in the *Guggenheim* case means that the grantor "can no longer withdraw the benefit from the named *cestui*." A reading of the phrase in its context will, we submit, indicate clearly that the Learned Justice used it in the sense of beyond recall to the grantor.

On page 11, Humphreys argues that the gift remains imperfect since "he had assured no economic benefit to anyone". This is not the case. On the execution of the trust indenture, Humphreys divested himself of all beneficial interest with respect to the remainder and cast it in others absolutely and forever. The group within which a change may occur is a broad group, perhaps, but it nevertheless explicitly excludes the grantor.

Humphreys asserts (p. 15) that there are three essential elements in a legal gift, namely, a donee capable of taking, an irrevocable relinquishment of

lominion and control, and an absolute and *in praesenti* ransfer to the donee. Whether these are or are not ssential elements is beside the point. An irrevocable gift in trust subject to contingencies in the trust deed nquestionably is a valid gift in trust and recognized is such. Similarly, a trust of the character involved in the *Sanford* case and a trust of the character involved in the *Humphreys* case is also undeniably a valid and effective gift in trust. Humphreys himself would be the first to deny that the instrument which he had executed was futile and ineffective. From the standpoint of the validity of the gift and the completeness of the transfer, the donee is the trustee as the representative of all interests, present and future, and all persons, determined and undetermined.

Humphreys' argument (pp. 16-17) predicated upon "the bundle of rights" constituting the property is also beside the point. On the creation of the trust, Humphreys surrendered rights of ownership sufficient to support an excise tax on "a transfer * * * by gift." In the case of a gift in trust, it is this transfer on which, we submit, Congress intended to lay the tax.

Humphreys refers (p. 18) to Section 504(b) of the 1932 Act conferring a specific exemption of $5,000 "in the case of gifts (other than a future interest in the property) made to any person". In the case of a gift in trust, the question is still open whether under this section there is only one $5,000 exemption or several exemptions depending on the number of beneficiaries named. The Board of Tax Appeals consistently has held that "any person" means the trust estate, and allows only one exemption. *Hutchins* v. *Commissioner*, 40 B. T. A. 27 and cases cited. We are inclined to think this is a sound interpretation. But certainly the question now before this Court is not affected by a possible ambiguity in the meaning of Section 504(b).

On pages 20 and 21, Humphreys indulges in a [illegible]ber of assumptions, such as, for example, the tent[illegible] designation of a charity as the recipient of the in[illegible] and the later substitution of non-charitable ben[illegible]aries. Such suggested cases serve only to becloud [illegible] primary issue here involved, and will properly [illegible] treated by the Commissioner when they arise. In [illegible] case suggested, the Commissioner might appro[illegible]ately impose a tax on the creation of the trust, s[illegible] in order to obtain the exemption it must be shown [illegible] the specified gift will be devoted "*exclusively*" to ch[illegible]table uses.† There is no greater hardship in [illegible] imposing a gift tax in such a case than there is in [illegible]posing an estate tax in respect of property which, [illegible]though initially enjoyed by a charity, may be diver[illegible] to non-charitable uses, or which, in the first insta[illegible] is contingently left to a charity. In both instances [illegible] rule is well established that the property neverthe[illegible] is subject to the estate tax. Regulations 80, Art. [illegible] *Humes* v. *U. S.*, 276 U. S. 487.

In summary.

Whatever the approach may be, whether it be [illegible] language of the Gift Tax Act itself, the consist[illegible] and uniform rule of the Regulations fortified by [illegible] language of the income tax provisions and the [illegible]clared purpose of Congress in enacting the stat[illegible] or the practical considerations weighed from [illegible] standpoint of the preservation of the revenue and [illegible] prevention of gift tax frustration and income [illegible] avoidance, surely the sound and equitable rule [illegible] gift tax purposes is the rule resting upon [illegible] grantor's power or lack of power to enjoy for h[illegible]

† See Article 16 of Regulations 79 (the Gift Tax Regulatio[illegible] which provides that if a gift is made to a charity and [illegible] charity "is empowered to divert a part of the property or fu[illegible] to a non-charitable purpose, to that extent the charitable exe[illegible]tion is denied.

self the economic benefits of the property. If, in view of the character and terms of the reserved power, the grantor may enjoy for himself the corpus and income, there is a retention of those fundamental property rights which negatives the existence of a taxable transfer. If, on the other hand, the grantor has irrevocably surrendered such rights and the enjoyment is lodged finally and for all time in others, it would seem that a taxable transfer has occurred and that a gift tax should be collected at that point, even though the grantor retains enough power to redesignate the recipients of his bounty. So construed, the Gift Tax Act is directly in harmony with the income tax provisions and the income tax decisions; so construed, it carries out one of the declared purposes of Congress in enacting the statute; so construed, it will avoid the dangers and pitfalls of tax postponement and tax avoidance; and so construed, it will fully implement and protect the estate tax and prevent estate tax avoidance. Considerations of this character are implicit in any question involving a search for the intention of the lawmakers.

Conclusion.

In conclusion, it is respectfully submitted that the decision of the Circuit Court of Appeals for the Third Circuit should be reversed, and the case remanded, with the direction to enter a judgment of no deficiency.

Respectfully submitted,

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